



ZATI POSITION PAPER ON VAT AMENDMENT

INTRODUCTION

Following the amendment made to the Value Added Tax Regulations, which came into force on 1st August 2013, many of our members have raised strong concerns about the impact that this change is having on the tourism industry.

As an organization trying to protect the interests of its members, ZATI is presenting this position paper in order to seek dialogue with the Government for a shared and sustainable solution to the detrimental effects that the continuous changes of the taxation legal frame are causing.

Zanzibar taxation system is administered by two distinct Government entities: the Tanzania Revenue Authority, spanning its authority over direct taxes as Income Tax and Customs Duty and the Zanzibar Revenue Board, managing indirect taxes as Stamp Duty, VAT and Hotel Levy.

In particular the Tourism sector, considering its importance as source of FDI and major contributor to the island economy, is subjected to a variety of taxes and levies. Among those taxes administered by the ZRB, the tourism sector indirect taxation is based on two different systems: Hotel Levy and Value Added Tax.

Since its inception, the dual system has created confusion and has put operators in an uneven position compared to other similar operators. While the rationale behind the two systems might have been the consideration of sizes and dimensions of establishments in order to favour smaller operators with a simple and concise taxation system, the practical results have actually created situations of unfair competition, undermining recognized taxation principles as equity and fairness, transparency and visibility, certainty and efficiency.

THE PROBLEM

This position paper focus on the amendment made to the Value Added Tax Regulations with which *'[...] no operator of hotel shall be registered under the Value Added Tax Act, unless his charging rate is not less than United States Dollars One Hundred or its equivalent in Tanzania Shillings per person per night.'*

The change poses a series of alarming questions putting at risk universally recognized taxation principles, setting conditions for an unfair competition among similar operators and affecting business performance lowering profits.

While no one enjoys paying taxes, most recognize that taxes are the price paid for the essential infrastructure and services provided by government and local administrations. In a free and prosperous society, citizens will generally comply with tax levies as long as certain criteria are met. First, political processes provide citizens with input as to how and to what extent they are taxed. Second, public officials serve as good stewards of the resources generated by the tax system. Finally, most citizens perceive that tax burdens and benefits are distributed in a fair and equitable manner.

In a complex economic and social environment, it may not be possible to design and administer a tax system that is fair and equitable in an absolute sense. However, a tax system that is generally perceived as fair and equitable is a desirable and achievable goal.

We believe this amendment violates the principle of equity and fairness where the tax platform is unable to aim to all tax payers in a proportional and/or progressive way thus creating discrimination among similar operators.

As a consequence of the violation of the principle of equity and fairness, similar operators will have distinct competitive positions, favouring VAT registered operators.

The amendment, in fact, will force all those operators not meeting the minimum requirement for eligibility to VAT registration to fall under the Hotel Levy system. This will bear a number of negative financial implications on the business performance and profitability, regardless of turnover volume and size of the establishment.

Hotel operators will now incur in additional expenses: all Input Tax on purchases will no longer be off set against Output Tax, thus becoming a new cost.

ZATI has looked into the problem with two different approaches complementing each other: a legal research and a financial analysis. We sought the opinion of legal experts in order to understand the effective legal frame this amendment came into force and we present a simple but explicative model showing the financial impact of the amendment on a given establishment.

The legal opinion, in consideration of the ambiguity in setting a single rate without clarifying its interpretation and real applicability, comes to the conclusion that the presence of just one rate of USD 100 within the establishment, is reason enough to challenge the de-registration from VAT system or the non-registration to the Zanzibar Tax Appeal Board. Furthermore, the amendment to the regulation poses a serious issue in terms of contravention of the main Act. It is suggested that judicial review is sought for being inconsistent with the principal legislation.

From the financial point of view, we have to present three different scenarios due to the fact that no clear criteria of applicability were offered by ZRB following the transition from a VAT system to Hotel Levy.

HOTEL LEVY SYSTEM Opt. A		HOTEL LEVY SYSTEM Opt. B		VAT SYSTEM	
Details	USD	Details	USD	Details	USD
Gross Revenue	2,360,000	Gross Revenue	2,360,000	Gross Revenue	2,360,000
Hotel Levy Expenses	(360,000)	Hotel Levy expenses	(424,800)	VAT (Output Tax)	(360,000)
Net Revenue	2,000,000	Net Revenue	1,935,200	Net Revenue	2,000,000
Operating Exp. Non Vatable	(600,000)	Operating Exp. Non Vatable	(600,000)	Operating Exp. Non Vatable	(600,000)
Operating Exp. Vatable	(400,000)	Operating Exp. Vatable	(400,000)	Operating Exp. Vatable	(338,983)
Operating Profit	1,000,000	Operating Profit	935,200	Operating Profit	1,061,017
Tax Expenses	(300,000)	Tax Expenses	(280,560)	Tax Expenses	(318,305)

Profit After Taxation	700,000	Profit After Taxation	654,640	Profit After Taxation	742,712
	<i>USD</i>		<i>USD</i>		<i>USD</i>
Hotel Levy	360,000	Hotel Levy	424,800	VAT Payable	298,983
Corporate Tax	300,000	Corporate Tax	280,560	Corporate Tax	318,305
Total Tax Payables	660,000	Total Tax Payables	705,360	Total Tax Payables	617,288

After consultation with ZRB it emerged that, with the transition from VAT to Hotel Levy there is no clear indication to what will constitute the total amount chargeable under Hotel Levy: the Net Revenue (as in option A) or the Gross Revenue (as in option B)?

In the above scenarios we have assumed that 40% of total operating expenses are carrying VAT and, for the purpose of this analysis, we did not take into consideration the depreciation and amortization affecting net taxable income.

As clearly shown, either option A or option B under Hotel Levy system, has a higher impact in terms of total taxes payable, therefore eroding part of the Net Profit.

The additional costs cannot be absorbed by or transferred to customers. The market set prices for services customers are ready to pay, in consideration of the level and quality of the services and the overall destination market positioning.

RECOMMENDATIONS

In consideration of the fact that the amendment poses threats to fair competition, violates universally recognized taxation principles, poses further doubts about its legitimacy and consistency with the main Act, affects profitability and lower the island investment appeal we propose a taxation system where simplicity, fairness and efficiency are essential pillars.

We believe the widening of the Tax Base will serve as a platform for and increased Government revenue collection, where taxes and levies are fairly and efficiently collected, used and redistributed in the form of services to taxpayers and citizens in general.

The Government should immediately repeal the amendment and implement the co-existing systems (VAT/Hotel Levy) as follows:

- VAT system should be applicable to ALL operators. Only, as per current legislation, a turnover threshold should be defined as demarcation line for eligibility to VAT system.
- Operators not meeting the turnover threshold should be under a revised Hotel Levy system with a lower rate (between 10% and 15%).

This will allow a wider base to contribute and effectively transferring the Value Added Tax to the final customer, as it foundation principle states, and will offer a less complex system for smaller establishment which will mitigate the cost of Input Tax through a lower Hotel Levy rate on sales.

ZATI remains committed to ensuring a sustainable and professional tourism industry of the highest standard and wants to continue to working with Government institutions to achieve the common goal of economic prosperity for Zanzibar without unnecessary and unfair taxation.